INDEX

CITATIONS

742-226—64——1

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 54

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE, PETITIONERS

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONERS

OPINION BELOW

The opinion of the court of appeals (R. 49–53) is reported at 325 F. 2d 914.

JURISDICTION

The judgment of the court of appeals was entered on December 23, 1963 (R. 53). The petition for a writ of certiorari was filed on March 23, 1964, and was granted on May 18, 1964 (R. 54; 377 U.S. 929). The jurisdiction of this Court rests on 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the Internal Revenue Service, in order to enforce a summons for the production of books and records relating to years as to which additional taxes may be still assessed in case of fraud, is required to show probable cause for believing that there was fraud.

STATUTES INVOLVED

Sections 6001, 6201, 6501, 7402, 7601, 7602, 7604, and 7605 of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*.

STATEMENT

On March 12, 1963, the Internal Revenue Service issued a summons directing respondent Powell, the president of respondent William Penn Laundry, Inc. ("the taxpayer"), to appear before petitioner Tiberino, a Special Agent of the Service, and to give testimony and produce specified books and records of the taxpayer relating to the latter's tax liability for the fiscal years ending July 31, 1958 and 1959 (R. 10a–11a).[1] Powell appeared before Tiberino, but upon advice of counsel declined to produce the records (R. 14a–16a). Noting that the statute of limitations barred assessment of any additional taxes for those years except in case of fraud, and that the records for those years had been previously examined, Powell

[1] Prior to the issuance of the summons, the Regional Commissioner of the Service had informed the taxpayer by letter that, "in order to properly verify its returns for those years," it was deemed necessary to make a reexamination of its books and records (R. 9a).

contended that "unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years" (R. 16a–17a). He told Agent Tiberino that "If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position" (R. 17a). Tiberino replied that "in view of the position taken today, there is no point in carrying this meeting any further at this time" (*ibid.*).

On May 20, 1963, the government instituted a proceeding in the District Court for the Eastern District of Pennsylvania to enforce the summons (R. 1a, 3a–5a). Attached to the petition for enforcement was an affidavit by Tiberino stating that, since February, 1963, he had been investigating the correctness of taxpayer's income tax returns for 1958 and 1959; that, on the basis of information obtained in the investigation, "he has reason to suspect" that the taxpayer filed false and fraudulent returns for those years with intent to evade its taxes and had attempted to evade such taxes "by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income;" and that, "based upon the above investigation," the Regional Commissioner of the Internal Revenue Service "determined that an additional examination" of the taxpayer's books and records for those years "was necessary" (R. 7a–8a).

In response to the petition, the respondents reiter-

ated their argument that, since the assessment of any additional tax for those years was barred by the statute of limitations unless there was fraud, the government was not entitled to examine the books and records for those years unless it offered "some justification for attempting to open the closed years in question," and that, although Agent Tiberino had been requested to give some justification, he had declined to do so (R. 22a–24a).

After hearing argument, the district court held that the allegation in Tiberino's affidavit that the taxpayer had overstated the amount of its purchases which were treated as expenses was sufficient to warrant a further investigation (R. 40a–41a) and, with certain limitations not here pertinent, enforced the summons (R. 45a).

The court of appeals reversed. It held that, in view of the prohibition in Section 7605(b) of the Code against subjecting taxpayers to "unnecessary examination or investigations," a reexamination of a taxpayer's records for years as to which the assessment of additional taxes is barred by the statute of limitations except in case of fraud "must be 'unnecessary' within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year" (R. 50–53). Rejecting the view of the Second Circuit in *Foster* v. *United States*, 265 F. 2d 183, certiorari denied, 360 U.S. 912, that the government need not establish probable cause that the tax-

payer had committed fraud during the closed years, the court stated (R. 51–52) that the requirement in Section 7604(b) of the Code that there be

> a "hearing" on the application to enforce the administrative summons at which "satisfactory proof" shall be made * * * means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. * * * This the court cannot do unless the agent discloses whatever may have created his suspicion. Since the agent in this case failed to make such disclosure, despite the taxpayer's formal request for it, his application for judicial assistance should have been denied [footnote omitted].

SUMMARY OF ARGUMENT

The holding of the court below—that the Commissioner, as a prerequisite to judicial enforcement of a summons issued in an investigation covering closed tax years, must establish that he has reasonable grounds or probable cause to suspect fraud—seriously interferes with the Commissioner's responsibility to detect frauds on the revenue, is an unwarranted curtailment of his investigatory authority under the Internal Revenue Code, and is not supported by either the language or the legislative history of the pertinent provisions of the Code.

The primary statutory limitation on the Commissioner's investigatory power is that the information sought may be relevant or material to one of the purposes for which he is authorized to make inquiry. One of those purposes is to determine the liability

of any taxpayer for any internal revenue tax, and the corporate books and records sought in the instant summons are obviously pertinent to whether a potential fraud liability exists. The only other statutory restriction is the prohibition in Section 7605(b) of the code against "unnecessary" examinations. The view of the court below—that an examination covering years as to which additional taxes may be assessed only in case of fraud is "unnecessary" within the meaning of this section unless reasonable grounds to suspect fraud are shown—finds no support in either the language or the legislative history of the statute. This provision was designed to protect taxpayers from harassment resulting from repeated but baseless investigations by revenue agents. The statute dealt with this situation by providing that an agent could not make a re-investigation until an authorized Treasury official had examined the case, and determined that the reinvestigation was in fact necessary and not undertaken for purposes of harassment. Here, the requisite determination of necessity was made by the Regional Commissioner, and respondents have made no showing to rebut the presumption of regularity attaching thereto. Moreover, if further proof was needed, the agent's affidavit—disclosing the existence of a potential fraud liability—was plainly sufficient to justify an additional examination, and the district court properly enforced the summons.

ARGUMENT

THE COMMISSIONER IS ENTITLED TO JUDICIAL ENFORCEMENT OF A SUMMONS FOR BOOKS AND RECORDS RELATING TO CLOSED INCOME TAX YEARS UPON A SHOWING THAT THE INFORMATION SOUGHT MAY BE RELEVANT AND MATERIAL TO AN INVESTIGATION TO DETERMINE WHETHER THERE WAS A FRAUDULENT UNDERSTATEMENT OF TAXABLE INCOME

A. INTRODUCTORY

The Commissioner of Internal Revenue has been conducting an investigation to determine whether the respondent corporation filed fraudulent returns for the years 1958 and 1959. Collection of any tax deficiencies for these years is barred by the ordinary 3-year statute of limitations unless the returns are fraudulent, in which case the tax may be assessed and collected at any time (Sec. 6501 (a), (c), Internal Revenue Code of 1954, App. *infra*, p. 24). The court below held that, since "the imposition of any additional liability on the taxpayer must be predicated upon fraud," logic dictated the conclusion that the examination was "unnecessary" within the meaning of Code Section 7605(b) (App. *infra*, p. 27) unless the Commissioner could show that he had reasonable grounds to suspect fraud (R. 51).

This is essentially the view of the First Circuit, which held that the Commissioner "must establish to the district court's satisfaction that a reasonable basis exists for a suspicion of fraud, or put another way, that there is probable cause to believe that the taxpayer was guilty of fraud in a statute barred year." *O'Connor* v.

O'Connell, 253 F. 2d 365, 370; *Lash* v. *Nighosian,* 273 F. 2d 185, certiorari denied, 362 U.S. 904.

This "probable cause" standard has been expressly rejected by the Second, Fifth, Sixth and Ninth Circuits. The Second and Sixth Circuits hold, in substance, that the requirements for judicial enforcement of a summons, with respect to closed years or otherwise, are satisfied when it is shown that the examination sought may be relevant and material to any of the purposes for which the Commissioner is authorized to make inquiry. *Foster* v. *United States,* 265 F. 2d 183 (C.A. 2), certiorari denied, 360 U.S. 912; *United States* v. *Ryan,* 320 F. 2d 500 (C.A. 6), certiorari granted, 376 U.S. 904, No. 12, this Term. The Fifth Circuit, in a brief opinion, stated that the argument in support of the probable cause standard "proceeds from a misconception of the nature of the subpoena power at issue here and of the conditions requisite to its exercise." *Globe Construction Co.* v. *Humphrey,* 229 F. 2d 148. The Ninth Circuit, while disavowing the probable cause test, takes the view that expiration of the period of limitations is one of the factors to be considered in determining whether the Commissioner has met what it regards as the proper test, *viz.:* "that the decision to investigate in aid of [a statutory] purpose was in fact reached as a matter of rational judgment based on the circumstances of the particular case." *De Masters* v. *Arend,* 313 F. 2d 79, 90, petition for certiorari dismissed, 375 U.S. 936.

The Fourth and Seventh Circuits have found it unnecessary to pass on the question, since the Commissioner's evidence in the cases reaching those courts met

the more stringent test of probable cause. *Wall* v. *Mitchell*, 287 F. 2d 31 (C.A. 4); *McDermott* v. *John Baumgarth Co.*, 286 F. 2d 864 (C.A. 7).

Thus, the issue here is what showing the government must make to obtain judicial enforcement of a summons seeking information with respect to years closed by the statute of limitations except in cases of fraud. We submit (1) that the Internal Revenue Service is entitled to judicial enforcement of a summons covering closed years upon showing that the material sought may be relevant and material to an inquiry which the Commissioner is authorized to make; (2) that the prohibition in Section 7605(b) of the Code against "unnecessary" examinations does not impose any additional requirement of showing probable cause, but was designed merely to protect taxpayers against harassing examinations by unduly zealous agents by requiring that, before a agent could reexamine a taxpayer's records, the Commissioner or his delegated representative (as distinguished from the agent himself) had to be satisfied "after investigation" that such a reexamination was "necessary"; and (3) that the district court properly enforced the summons in the present case since the corporate records sought are relevant and material in determining whether there is fraud, and that there is therefore no basis for any claim that taxpayer is being harassed by an "unnecessary" examination.

B. THE INTERNAL REVENUE CODE GIVES THE COMMISSIONER BROAD INVESTIGATORY POWERS AND HE IS NOT REQUIRED TO SHOW PROBABLE CAUSE TO OBTAIN JUDICIAL ENFORCEMENT OF A SUMMONS

Under the Internal Revenue Code of 1954, the Commissioner of Internal Revenue is "required to make the inquiries" necessary to the determination and assessment of all taxes imposed by the revenue laws (Sec. 6201). He is further specifically directed to "cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax * * *" (Sec. 7601). To supplement these powers of inquiry, the Commissioner is authorized to summon any person to appear and produce books or records and give testimony which "may be relevant or material to" "the purpose of ascertaining the correctness of any return, * * * determining the liability of any person for any internal revenue tax * * *, or collecting any such liability * * *" (Sec. 7602). By the same token, Congress has provided that taxpayers shall keep records under regulations prescribed by the Commissioner (Sec. 6001), and the pertinent regulations require that the records be kept "at all times available for inspection" by revenue agents and retained as long as they may be "material in the administration of any internal revenue law." Treasury Regulations on Income Tax (1954 Code), Sec. 1.6001-1 (a), (e) (26 C.F.R. 1.6001-1 (a), (e)).

To enable the Commissioner to carry out effectively his investigatory duties, federal courts are vested with

jurisdiction to compel compliance with a summons "by appropriate process" (Secs. 7402(b), 7604(a)). The normal procedure, as here, is an application by the Commissioner for an order to show cause why the person summoned should not be ordered to comply. There results "an adversary proceeding affording a judicial determination of the challenges to the summons." *Reisman* v. *Caplin*, 375 U.S. 440, 446. While it is clear that the respondent may attack the administrative subpoena "on any appropriate ground," constitutional or otherwise (*id.*, at 449), there is no hint anywhere that, in a case like this, the Commissioner must establish "probable cause" to believe that the taxpayer is guilty of fraud. Indeed, no such standard is announced even for the extreme case (not here involved) where an order of arrest is sought under Section 7604(b) because the witness has "wholly made default or contumaciously refused to comply." See *Reisman* v. *Caplin*, *supra*, at 448–449. The prerequisite of "satisfactory proof" mentioned there seems plainly directed to the fact of default, not to the validity of the summons, an issue reserved for the subsequent "hearing." *Id.*, at 448. But, in any event, the language of that provision is wholly irrelevant to this case, in which no attachment was requested or needed.[2]

[2] The opinion below (R. 51) erroneously relied on the "satisfactory proof" and "hearing" language of Section 7604(b). This was, at least in part, attributable to the government's mislabelling of its complaint (which, however, did not request arrest of the witness) under that provision (R. 3a). Both errors occurred before this Court's decision in *Reisman* v.

Finally, enforcement of a summons is subject to the restriction that

> No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of the taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary. [Sec. 7605(b).]

In sum, so far as here relevant, judicial enforcement of the Commissioner's summons is subject to three statutory limitations: (1) that the information sought must be for one of the purposes enumerated in Section 7602; (2) that such information "may be relevant or material" to the inquiry (Sec. 7602); and (3) that the examination must not be "unnecessary" (Sec. 7605(b)). Putting aside for a moment this last restriction against "unnecessary" examinations, we note that the requirements of relevance and materiality to a statutory purpose are precisely those which this Court has announced as the governing criteria for judicial enforcement of an administrative summons. Enforcement will be granted upon "the court's determination that the investigation is authorized by Congress, is for a purpose Congress can order, and the documents sought are relevant to the inquiry." *Okla. Press Pub. Co.* v. *Walling*, 327

Caplin, *supra*, made it clear that Section 7604(b) applied only to cases in which arrest was sought because the witness "wholly made default or contumaciously refused to comply." *Id.*, at 448.

U.S. 186, 209; *United States* v. *Morton Salt Co.*, 338 U.S. 632, 652.[3] In so holding, the Court rejected the notion that the administrative agency, as a prerequisite to enforcement of its investigative power, was required under the Fourth Amendment to show "probable cause" to suspect a violation of law (327 U.S. 209–213). As this Court noted in *Morton Salt*, the administrative power of inquisition is "more analagous to the Grand Jury, which does not depend on a case or controversy for power to get evidence, but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not" (338 U.S. at 642–643). Responding to the argument that such a rule would enable an administrative agency to engage in a mere "fishing expedition" to see if it can turn up evidence of guilt, the Court was willing to "assume for the argument that this is so. * * * Even if one were to regard the request for information in this case as caused by nothing more than official curiosity, nevertheless, law-enforcing agencies have a legitimate right to satisfy themselves that corporate behavior is consistent with the law and the public interest" (338 U.S. at 641, 652).

The narrow question remaining is whether Congress intended to impose a requirement of probable cause by the prohibition in Section 7605(b) of the Code against "unnecessary" examinations. As we shall

[3] The Constitution also protects against demands which are too indefinite in breadth. (327 U.S. at 195, 208–209; 338 U.S. at 652.)

now demonstrate, the language of the statute and its legislative history compel a negative answer to this question.

C. SECTION 7605(b) AND ITS LEGISLATIVE HISTORY DO NOT SUPPORT A REQUIREMENT OF PROBABLE CAUSE

In determining what Congress meant by an "unnecessary" examination, the first principle of construction is that "statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them." *DeGanay v. Lederer*, 250 U.S. 376, 381. "Unnecessary" is defined in Webster's New International Dictionary (2d ed. 1949) as "needless, useless or not required under the circumstances." Can the instant investigation—the purpose of which is to determine if respondent corporation filed fraudulent returns—be deemed an "unnecessary" one within the meaning of that definition? The court below answered in the affirmative on the ground that, since "the imposition of any additional liability upon the taxpayer must be predicated upon fraud," the present examination must be "[l]ogically * * * 'unnecessary'" unless there are reasonable grounds to suspect fraud. (R. 51).

We fail to see why this is so. A statute which bars assessment of additional tax deficiencies in the absence of fraud cannot be construed to restrict an investigation to determine if fraud exists. Indeed, since assessment of additional taxes *within* the three year period (whether or not due to fraud) must be predicated upon the existence of a tax deficiency, the court's reasoning would also require the Com-

missioner to establish reasonable grounds to suspect a *deficiency* before proceeding with his investigation. To impose a probable cause requirement in this latter situation would be clearly inconsistent with the Commissioner's broad power to make inquiries of any person who "may be liable" to pay any tax (Sec. 7601), and to investigate for "the purpose of ascertaining the correctness of any return" (Sec. 7602). Yet, if probable cause is not a prerequisite to an investigation within the three year period (as we submit is obviously the case), then how can it be required here? The absence of any statute of limitations means that there is always a potential fraud liability about which to "inquire." *Foster* v. *United States*, 265 F. 2d at 187. And expiration of the normal three year period in no way diminishes the Commissioner's responsibility to determine "the liability of any person for any internal revenue tax" (Sec. 7602), which "surely includes liability which may be assessed on a finding of fraud." *De Masters* v. *Arend*, 313 F. 2d at 89. Therefore, the present fraud investigation falls squarely within the terms of the Commissioner's statutory authorization, and as such can hardly be deemed "unnecessary."

Our conclusion accords with the clearly defined Congressional policy to guard against frauds on the revenue, which is reflected in the imposition of severe criminal and civil penalties[4] and the extraordinary

[4] If *any part* of the deficiency is due to fraud, a civil penalty of 50 percent of the *entire* deficiency is imposed. Sec. 6653(b), Internal Revenue Code of 1954.

provision removing the bar of limitations in the case of civil fraud. Congress has given statutory recognition to the obvious fact that fraud in a return is ordinarily detected and proved only after a most painstaking and time-consuming investigation. Cf. *Colony, Inc.* v. *Commissioner*, 357 U.S. 28, 36.[5] To require a showing of probable cause at precisely the time when the Commissioner most needs his full array of investigative powers would seriously impair his efforts to detect fraudulent returns.[6] As we now show, the pertinent legislative history of Section 7605(b) clearly reveals that Congress never intended

[5] The *Colony* case, *supra*, involved Section 275(c) of the 1939 Code (the predecessor of 1954 Code Section 6501 (e)(1)(A)), which provided a special five-year period of limitations (now six years) where a taxpayer, even though acting in good faith, "omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return * * *." This Court stated that, in enacting this provision, "Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors."

[6] Section 7605(b), by its express terms, indicates that it was designed specifically for the protection of the taxpayer personally. The section would appear to have no application to inquiries made of third parties even though concededly part of an investigation directed solely to the taxpayer's liability. The Second Circuit so holds. *Application of Magnus*, 299 F. 2d 335, certiorari denied, 370 U.S. 918. However, the Ninth Circuit takes a contrary view, *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731, 735-736; cf. *De Masters* v. *Arend*, *supra*, p. 86, fn. 14. To adopt the probable cause test, and further to hold that this rule also applies to examinations of third persons, would make it virtually impossible to bring a fraudulent taxpayer to book.

to impose any probable cause or similar requirement.

Section 7605(b) first appeared as Section 1309 of the Revenue Act of 1921, c. 136, 42 Stat. 227. The purpose of the proposed provision, as stated in the Report of the House Ways and Means Committee, was to meet the complaints of taxpayers "that they are subjected to onerous and unnecessarily frequent examinations and investigations by revenue agents." H. Rep. No. 350, 67th Cong. 1st Sess., p. 16 (1939–1 Cum. Bull. (Part 2) 168, 180.) Congressman Hawley, in introducing the provision in the House, stated (61 Cong. Record, Part 5, p. 5202):

> Mr. HAWLEY. * * * We had instances before us where the books of a corporation or an individual had been examined four or five times, with four or five different assessments of taxation. There ought to be one levy of tax, one determination of it. It ought to be settled once for all when a man pays his tax, unless there should be good cause for a reexamination. * * *
>
> * * * * *
>
> Mr. CONNELL. There should not be another examination unless the first examination was wrong, and in that case the taxpayer should be notified in writing, should he not?
>
> Mr. HAWLEY. The gentleman is right, and we so provide. Of course the commissioner would not cause a frivolous examination to be made or an examination to be made on a frivolous ground. * * *

The report of the Senate Finance Committee, like the report of the House, confirmed that the measure

was "designed to meet the complaint of taxpayers that they are subjected to onerous and unnecessarily frequent examinations and investigations by revenue agents." S. Rep. No. 275, 67th Cong., 1st Sess., p. 31 (1939–1 Cum. Bull. (Part 2) 181, 203). When the measure reached the Senate floor, its purpose was further explained as follows (61 Cong. Record, Part 6, p. 5855):

> Mr. WALSH of Massachusetts. Mr. President, I think the chairman in charge of the measure ought to explain the importance of that provision, which I think is a very beneficial one, and perhaps call attention to the change it makes in existing law. It is a provision of which I heartily approve, but I think it is of such importance that some comment ought to be made upon it at this time.
>
> Mr. PENROSE. Mr. President, the provision is entirely in the interest of the taxpayer and for his relief from unnecessary annoyance. Since these income taxes and direct taxes have been in force very general complaint has been made especially in the large centers of wealth and accumulation of money, at the repeated visits of tax examiners, who perhaps are overzealous or do not use the best of judgment in the exercise of their functions. I know that from many of the cities of the country very bitter complaints have reached me and have reached the department of unnecessary visits and inquisitions after a thorough examination is supposed to have been had. This section is purely in the interest of quieting all this trouble and in the interest of the peace of mind of the honest taxpayer.

> Mr. WALSH of Massachusetts. So that up to the present time an inspector could visit the office of an individual or corporation and inspect the books as many times as he chose?
>
> Mr. PENROSE. And he often did so.
>
> Mr. WALSH of Massachusetts. And this provision of the Senate committee seeks to limit the inspection to one visit unless the commissioner indicates that there is necessity for further examination?
>
> Mr. PENROSE. That is the purpose of the amendment.
>
> Mr. WALSH of Massachusetts. I heartily agree with the beneficial results that the amendment will produce to the taxpayer.
>
> Mr. PENROSE. I knew the Senator would agree to the amendment, and it will go a long way toward relieving petty annoyances on the part of honest taxpayers.

These recitals make it abundantly clear that the only purpose of Section 7605(b) was to prohibit examinations which were "unnecessary" in the sense that they were repetitive to the point of harassment. *De Masters* v. *Arend*, 313 F. 2d at pp. 87–88. The statute remedied this situation by subjecting revenue agents to more stringent control at the administrative level, *viz:* a revenue agent could not conduct a re-examination of a taxpayer's books unless the Commissioner (or his delegated representative)[7] was satisfied "after investigation," that such a re-examination was "necessary". In the instant case, the findings of

[7] See Treasury Regulations, Sec. 301.7605–1(b) (26 C.F.R. 301.7605(b)).

agent Tiberino, with respect to the potential fraud liability of respondent corporation, were examined by Regional Commissioner Barron, who determined that an additional examination was necessary (R. 4a, 7a, 9a), and notified the taxpayer in writing to this effect (R. 9a).

Given the presumption of regularity which attaches to the acts of public officers (cf. *Wilson* v. *Schnettler*, 365 U.S. 381, 383), we cannot assume that the Regional Commissioner would have sanctioned a reexamination that was not "necessary", one that was undertaken only to harass or annoy the taxpayer or which sought information which was not "relevant or material" to an authorized inquiry. The only evidence offered by the taxpayer to rebut the presumption of necessity arising from the Commissioner's determination was that, in the absence of fraud, the statute of limitations on assessment of taxes had run as to the years involved. However, as we have previously shown, the expiration of the three-year statute did not make the examination "unnecessary," or even less "necessary," since the Commissioner clearly has the authority to examine records in order to ascertain whether a potential fraud liability exists. Accordingly, since the respondent corporation made no showing to impair the presumption of necessity, we submit that the district court should have enforced the summons on this basis alone.

In any event, however, if any further proof were needed, the agent's affidavit amply demonstrated to the court that the Regional Commissioner's decision to authorize the reexamination was justified. The affidavit stated that, "on the basis of information obtained in" a three-month investigation of the taxpayer's corporate income tax returns for the fiscal years 1958 and 1959, the agent had reason to suspect that the corporation "has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years" (R. 7a–8a). With information of overstated deductions in its possession, the Internal Revenue Service knew that respondent corporation might be liable for additional taxes due to fraud, and it would have been remiss if it had not pursued its investigation. The corporate books and records as to which examination is sought are obviously "relevant or material" in determining whether or not a fraud liability exists, and respondents have made no claim that production would be burdensome or oppressive. Nor have they raised any issue of arbitrariness or bad faith on the part of the Service. In sum, there is no basis for any claim that taxpayer is being subjected to an "unnecessary" investigation, and the district court was fully warranted in enforcing the summons.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
JOSEPH M. HOWARD,
NORMAN SEPENUK,
Attorneys.

AUGUST, 1964.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6001. NOTICE OF REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS.

Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary or his delegate it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax under this title.

SEC. 6201. ASSESSMENT AUTHORITY.

(a) AUTHORITY OF SECRETARY OR DELEGATE.—The Secretary or his delegate is authorized and required to make the inquiries, determinations, and assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title, or accruing under any former internal revenue law, which have not been duly paid by stamp at the time and in the manner provided by law. Such authority shall extend to and include the following:

(1) TAXES SHOWN ON RETURN.—The Secretary or his delegate shall assess all taxes determined by the taxpayer or by the Secretary or his delegate as to which returns or lists are made under this title.

* * * * *

(d) DEFICIENCY PROCEEDINGS.—

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) * * * and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * * *

(c) EXCEPTIONS.—

(1) FALSE RETURN.—In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) WILLFUL ATTEMPT TO EVADE TAX.—In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

SEC. 7402. JURISDICTION OF DISTRICT COURTS.

* * * * *

(b) To Enforce Summons.—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides or may be found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

* * * * *

(26 U.S.C. 7402.)

SEC. 7691. CANVASS OF DISTRICTS FOR TAXABLE PERSONS AND OBJECTS.

(a) General Rule.—The Secretary or his delegate shall, to the extent he deems it practicable, cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

* * * * *

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

SEC. 7604. [As amended by Sec. 4(i), Act of April 2, 1956, c. 160, 70 Stat. 87, and Sec. 208(d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374].

ENFORCEMENT OF SUMMONS.

(a) JURISDICTION OF DISTRICT COURT.—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(b) ENFORCEMENT.—Whenever any person summoned under section 6420(e)(2), 6421(f)(2), or 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary or his delegate may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It

shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

* * * * *

SEC. 7605. [As amended by Sec. 4(i), Act of April 2, 1956, c. 160, 70 Stat. 87 and Sec. 208(d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374].

TIME AND PLACE OF EXAMINATION.

(a) TIME AND PLACE.—The time and place of examination pursuant to the provisions of section 6420(e)(2), 6421(f)(2), or 7602 shall be such time and place as may be fixed by the Secretary or his delegate and as are reasonable under the circumstances. In the case of a summons under authority of paragraph (2) of section 7602, or under the corresponding authority of section 6420(e)(2) or 6421(f)(2), the date fixed for appearance before the Secretary or his delegate shall not be less than 10 days from the date of the summons.

(b) RESTRICTIONS ON EXAMINATION OF TAXPAYER.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

U. S. GOVERNMENT PRINTING OFFICE:1956

IN THE

Supreme Court of the United States

October Term, 1964.

No. 54.

UNITED STATES OF AMERICA and ERNEST J. TIBERINO, JR., Special Agent, Internal Revenue Service,
Petitioners,

v.

MAX POWELL and WILLIAM PENN LAUNDRY, INC.,
Respondents.

On Writ of Certiorari of the United States Court of Appeals for the Third Circuit.

Brief for the Respondents.

BERNARD G. SEGAL,
SAMUEL D. SLADE,
THOMAS B. RUTTER,
Attorneys for Respondents.

SCHNADER, HARRISON, SEGAL & LEWIS,
1719 Packard Building,
Philadelphia, Pennsylvania 19102.

International, 711 So. 50th St., Phila., Pa. 19143

INDEX.

TABLE OF CASES CITED.

STATUTES AND RULES CITED.

QUESTION PRESENTED.

Whether the court below was correct in holding that the Internal Revenue Service, seeking judicial enforcement of its summons to produce a taxpayer's books and records for years as to which tax assessment and collection are time barred, must, upon challenge by the taxpayer, show the existence of facts which would justify a reasonable man in suspecting the existence of fraud or a willful intent to evade taxes, so as to lift the statutory time bar.

STATEMENT.

On February 26, 1963, the Regional Commissioner of Internal Revenue, Dean J. Barron, sent a form letter to the taxpayer, William Penn Laundry, Inc., which stated, "• • • it is deemed necessary to make a reinvestigation of the books and records of the William Penn Laundry, Inc. for the fiscal years ending July 31, 1958 and July 31, 1959 in order to properly verify its returns for those years. A re-examination, therefore, will be made" (R. 9a). The letter declared that it was sent in compliance with "• • • Section 7605 of the Internal Revenue Code of 1954" (R. 9a). No further statement of the purpose or grounds for the demand in the February 26 letter was proffered.

The books and records for the fiscal years covered by the letter—1958 and 1959—had earlier been examined by Internal Revenue Agents, at which time technical adjustments were made and deficiency taxes were assessed and paid (R. 22a-23a). Assessment and collection of taxes for these years, except in the event of fraud or wilful attempt to evade payment of taxes, was time-barred; at the time of the demand, 1958 and 1959 were "closed years". 26 U. S. C. § 6501.[1]

The letter was followed by a summons, dated March 12, 1963, directed to Mr. Max Powell, President of William Penn Laundry, Inc.[2] (R. 10a-11a). This summons, covering the same fiscal years and declaring that it was "Issued under authority of Section 7602, Internal Revenue Code of 1954," was signed by Special Agent Ernest J. Tiberino, Jr. It directed Mr. Powell to

> "• • • produce for examination the following books, records, and papers • • •

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1. Unless otherwise indicated, all references to statutory sections herein are to the Internal Revenue Code of 1954.

2. During the years involved in this case, Mr. Lawrence C. Kline was President and sole stockholder of the Company. Mr. Powell became President upon Mr. Kline's death but has no stock interest in the Company.

"Minute books

"Stock certificate books

"General ledgers

"General journals

"Purchase journals and cash disbursement journals

"Sales journal and cash receipts journals and all subsidiary records kept to substantiate the entries in the above-mentioned records." (R. 10a)

Mr. Powell appeared on March 25, 1963 at the appointed hour and place at the Internal Revenue Service offices in Philadelphia but declined, on the advice of counsel, to produce the books or records demanded (R. 15a-16a). Counsel for the taxpayer made plain on the record the basis of his advice to Mr. Powell:

"* * * It is his desire, and the company's desire, to cooperate in every way that is proper and legal. However, in view of the fact that the Statute of Limitations has expired for the two years for which time you have requested records, plus the fact that these years were previously examined and the principal officer at the time is no longer living, I have advised Mr. Powell to decline to produce these records and to waive any legal rights which the corporation may have or which he may have.

"It is our position that this is an unreasonable examination, and in view of the expiration of the Statute of Limitations, such examination would be illegal. To Mr. Powell's knowledge, the returns of the corporation for the years in question are correct and he has no reason to know of any discrepancies which could be the basis for an allegation of fraud. Under the circumstances, unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years.

* * *

> "If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position. Unless that is done, however, we have no alternative but to abide by the Statute of Limitations provision in the Internal Revenue Code." (R. 16a-17a)

Special Agent Tiberino's response to this request to give "some indication" as to the reason for the investigation and demand to produce was:

> "O. K. gentlemen, in view of the position taken today, there is no point in carrying this meeting any further at this time." (R. 17a)

The administrative proceeding was thereupon adjourned.

Two months later—May 20, 1963—a petition to enforce the Internal Revenue Service summons, based on Section 7604(b) of the Internal Revenue Code of 1954, 26 U. S. C. 7604(b), was filed in the District Court for Eastern District of Pennsylvania (R. 3a-5a). The petition referred to the letter of demand and the summons, but set forth no factual basis for the administrative demand that the books and records be made available. The petition merely alleged that the taxpayer had been notified that "• • • an additional inspection of [the taxpayer's] books and records was necessary" (R. 4a).

Attached to the petition was an affidavit of Special Agent Tiberino (R. 7a-8a). In the affidavit, the Special Agent said that, based upon his investigation of the corporate income tax returns of this taxpayer, "• • • the Regional Commissioner • • • determined that an additional examination • • • was necessary" (R. 7a). Special Agent Tiberino also stated that he had delivered to Mr. Powell the letter which set forth that "• • • an additional inspection of their books and records was necessary" (R. 7a). Giving, for the first time in these proceedings, any indication whatever of the occasion for the proposed

re-examination, the Special Agent asserted in the affidavit filed in the district court that "• • • he has reason to suspect that the William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958, and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years" (R. 7a-8a).[3]

The petition to enforce prayed that "• • • the Court enter an order directing the respondent, Max Powell, to obey the aforementioned summons in each and every requirement thereof, and to order the attendance and production of books and records as required and called for by the terms of such summons before Special Agent Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service, at such time and place as may be hereafter fixed by said Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service" (R. 5a).

On May 27, 1963, an order was issued by the district court, returnable on June 5, 1963, directed against Powell, to show cause why the demanded books and records should not be produced for inspection (R. 2a). A response to the show cause order was filed on behalf of the taxpayer (R. 22a-24a).

At the hearing on the order to show cause, the Internal Revenue Service persisted in its position, begun with the Regional Commissioner's letter of February 26th, that the taxpayer must produce the records on the basis of an unsupported administrative demand (R. 31a-32a, 36a). Recognizing that assessment and collection of taxes for the years in question were time-barred unless the case fell

3. The affidavit did not, however, give any clue as to the assets as to which there had been an alleged overstatement, or how "purchases", an element in cost of goods sold, could have been reported as "expenses".

within one of the statutory exceptions, Internal Revenue nevertheless stated (R. 29a-30a) "* * * the Government should not be required to prove grounds for belief that the liability was not time barred." Accordingly, Internal Revenue refused to produce the Special Agent, or any witness, to support the demand.

In the alternative, Internal Revenue urged the district court to accept Tiberino's affidavit as a sufficient showing of probable cause and argued that Tiberino's affidavit was sufficient to justify judicial enforcement (R. 31a). Counsel for the taxpayer, on the other hand, pointed out that there had been no "* * * attempt to justify or explain * * *" the demand and that there were no facts shown whatsoever to support the Special Agent's general statement that he had "* * * reason to suspect * * *" fraud (R. 35a).

The district judge expressed dissatisfaction with the refusal of the Internal Revenue Service to present testimony and stated agreement with the position taken by taxpayer (R. 31a-32a, 36a-38a). Nevertheless, the district judge decided upon a compromise order whereby he permitted examination of the taxpayer's books and records for one hour only. He declared:

> "* * * I am inclined to go along with [counsel for taxpayer's] argument from reading this, but as a practical matter, an hour examination of these books in a courteous way, understand—I don't know how the Special Agent acts, but if he will do this in a courteous way and a kindly way, without assuming these people are guilty of anything, I am inclined to let them have an hour to do this." (R. 37a-38a) [4]

4. In its brief in this Court (Br., p. 4), as in its petition for certiorari (Pet., p. 8), the Government refers to this curious order of the district court as containing "* * * certain limitations not here pertinent * * *". Elsewhere, the Government's brief (p. 21) states that the district court "was fully warranted in enforcing the summons". Actually, it is apparent, and the transcript of the hearing bears this out, that the district judge actually sought to avoid resolution of the issue presented (R. 37a-39a).

Counsel for the taxpayer, of course, protested this ruling, stating that the taxpayer should not be ordered to turn its books over to the Special Agent "* * * just because he wants to see them * * *" but that "* * * the crux of this case * * *" was whether the Special Agent had established the right to see the books (R. 40a).

Following some further colloquy, the district court entered an order setting June 10, 1963, from 10:00 to 11:00 A. M. as the period during which the Agents should have access to the books (R. 45a).

The taxpayer appealed from this order on June 7, 1963 and, pursuant to stipulation, an order was entered on June 10, 1963, staying the scheduled one hour examination (R. 46a). In order to make perfectly plain the principle at issue in this case, the taxpayer agreed that if the position of the Internal Revenue Service were sustained, the Agents should be permitted a reasonable time, not limited to one hour, in which to complete a re-examination (R. 47a).

The Court of Appeals for the Third Circuit, in an opinion by Judge Hastie, reversed the district court (R. 49-53). Speaking for a unanimous court, Judge Hastie first considered the question of the district court's responsibility when called upon to enforce a demand by the Internal Revenue Service such as that here involved. Referring to Section 7604(b) on which the petition to enforce was grounded, Judge Hastie rejected the argument of the Service that the basis for the Special Agent's suspicion of fraud was not a matter for judicial cognizance. Section 7604(b) requires the production of "* * * satisfactory proof * * *" and "* * * a hearing of the case * * *" as the basis for "* * * such order as [the judge] shall deem proper * * *".

Since assessment or collection of taxes was here time-barred under Section 6501, and since Section 7605 of the Internal Revenue Code of 1954 prohibits unnecessary examinations, the court below concluded "Logically, therefore, a reexamination of his records must be 'unnecessary'

within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year • • •" (R. 51). Therefore, inasmuch as the Internal Revenue Service had not disclosed any facts which might cause a reasonable man to suspect fraud, any facts sufficient to show "• • • that the decision to proceed was not arbitrary", the court held that the Internal Revenue Service summons was not entitled to judicial enforcement (R. 53).

SUMMARY OF ARGUMENT.

In this case, the Internal Revenue Service called upon a federal district court to enforce a summons which directed the taxpayer to produce books and records for closed years. The petition alleged no more than that the taxpayer had been notified that the requested examination was necessary.

The Internal Revenue Service takes the position that, on this basis alone, the order of enforcement should have been issued by the court. The argument of the Service, in support of its position, is that the only limitation upon its power to investigate is the prohibition against "* * * unnecessary examination * * *" in Section 7605(b), and that the prohibition of this section is fully satisfied by an administrative determination of necessity.

The court below correctly rejected this argument, an argument which has, in fact, never been accepted by any court when called upon to enforce an Internal Revenue summons. Rather, the decision below was properly grounded in a reading of the various applicable sections of the Internal Revenue Code as an integrated whole, including those sections which deal with the responsibility of federal courts in enforcement cases. The result below, and the reading there given to the statutory sections involved, fully accord with this Court's decision in **Reisman v. Caplin**, 375 U. S. 440 (1963).

The first point of analysis is an examination of the various sections of the Code here involved. The power to investigate granted to the Internal Revenue Service by Section 7602 pre-supposes investigations for a lawful purpose, *i.e.*, the Internal Revenue Service can investigate where it possesses the power to assess and collect income tax. Here, Section 6501 prohibits assessment unless it takes place within three years of the date upon which the return in question is filed, unless this time bar upon the

investigative powers of Internal Revenue is lifted on the sole ground that the case involves fraud or another of the stated exceptions to Section 6501. A further limitation on the investigative power of Internal Revenue is supplied by the prohibition against "* * * unnecessary examination or investigations * * *" of Section 7605(b). Construing these sections together, the court below correctly concluded that, absent a showing of a reasonable basis for suspecting that the matter falls within an exception to the statute of limitation section, the demand of Internal Revenue for enforcement must be viewed as unnecessary and prohibited, because time-barred.

The conclusion reached by analysis of those sections of the Code which deal with the investigative powers of the Internal Revenue Service is re-enforced by consideration of the sections which deal with judicial enforcement of an Internal Revenue summons. Whichever enforcement procedure is followed, it is clear that the taxpayer is entitled to an adjudication of his challenges to the summons in an adversary proceeding. The dispositive principle is clearly expressed in this Court's decision in the **Reisman** case.

The constitutional decisions, upon which the Government relies in support of its argument, are not apposite. Those decisions pre-suppose that the Administrative investigations, being challenged on Fourth and Fifth Amendment grounds, was within the statutory authority of the agency. Here, of course, the very question is whether Internal Revenue has statutory power to make its proposed investigation.

An analysis of all of the reported cases which have considered the question here presented shows plainly that on no occasion has the argument which Internal Revenue advances been accepted. In any case in which enforcement has been granted, the court's order has been based on a record which contains some showing by Internal Revenue of factual support for its suspicion. The earliest

cases flatly rejected an argument somewhat similar to that here advanced by Internal Revenue, *i.e.*, that no showing need be made. And, for a time, the Internal Revenue Service seemingly accepted the rule that it must make a showing of probable cause in order to obtain judicial enforcement. It is significant that the Internal Revenue laws have, since these early decisions, been twice thoroughly examined and codified by Congress. At no time has Internal Revenue sought to obtain from Congress statutory language which would convey the unlimited investigative power for which it here argues. To the contrary, Congress has twice re-enacted the language of the sections involved in this case, as judicially construed, without any material change.

The principal argument of Internal Revenue—the only argument which relates to the single question presented by the Government's petition for certiorari—is, as we have shown, that the court must grant enforcement of a summons upon a certification that there has been an administrative determination of necessity. In the alternative, and accepting the rule that probable cause must be shown, Internal Revenue urges this Court to accept a general conclusory statement of suspicion contained in an affidavit of Special Agent Tiberino as a sufficient showing. The Government's petition for certiorari did not present any question as to the adequacy of the showing made by the Service in the district court and, accordingly, this alternative argument is not available to the Government in this Court. Rule 40(d)(2). In any event, no court has ever accepted a comparable statement as a sufficient showing of fact and several cases have specifically rejected general statements contained in affidavits by agents, as a sufficient basis upon which to grant enforcement. More to the point, however, is the fact that, in a related case, containing precisely the same general statement by the same Special Agent, the Internal Revenue Service elected to produce proof, offering further affidavits and live testi-

mony. After hearings, argument and briefing, the federal district judge before whom the case came, concluded that Internal Revenue had failed to show any sufficient facts to justify a reasonable man in suspecting fraud. In short, Internal Revenue was entirely unable to substantiate its suspicion. Nevertheless, it here calls upon this Court to accept the charge itself as an adequate showing of facts upon which a reasonable man would suspect the existence of fraud in the taxpayer's returns for 1958 and 1959.

Argument.

THE COURT BELOW CORRECTLY HELD THAT THE INTERNAL REVENUE SERVICE WAS NOT ENTITLED TO JUDICIAL ENFORCEMENT OF ITS SUMMONS SINCE THE SERVICE MADE NO SHOWING OF FACTS WHICH WOULD LEAD A REASONABLE MAN TO SUSPECT THAT THE CASE CAME WITHIN AN EXCEPTION TO THE APPLICABLE STATUTE OF LIMITATIONS.

Introductory Statement.

The petition for enforcement which, the Government contends, should be held sufficient to justify a district court order directing this taxpayer to produce its books and records for closed years, alleges no more than that the Regional Commissioner deemed it necessary that examination of such books take place, and that the taxpayer had been so notified (R. 3a-4a). In other words, the Government's basic position here is that the mere statement, without more, that an administrative determination that an examination is necessary has been made, requires a federal district court, upon application by the Internal Revenue Service, to compel compliance by the taxpayer.[5]

The argument in support of this contention consists principally of isolating Section 7605(b) from the other relevant provisions of the Internal Revenue Code and treating that section alone as critical in determining the circumstances in which judicial enforcement will be forthcoming. Accepting the prohibition against "* * * un-

5. We are here dealing with the sole question presented by the Government's petition for a writ of certiorari (Pet., p. 2). See also, Gov't. Brief, p. 2. As to a contention with respect to the sufficiency of Tiberino's affidavit, not raised as a question presented in the petition, see *infra*, pp. 39-42.

necessary examination * * *" contained in Section 7605(b) as a limitation upon the right to obtain judicial enforcement of a summons (Br., p. 13), the Government urges that the requirement is met where the Regional Commissioner determines, after investigation by him, that an examination of the books and records in question is necessary (Gov't. Br., pp. 19-20).[6] The argument next attaches a presumption of regularity to the determination of the Regional Commissioner, which is then transformed into a "* * * presumption of necessity * * *" (Gov't. Br., p. 20). Thereupon, in the Government's view, a district court must enforce this summons unless the taxpayer somehow overcomes this "* * * presumption of necessity * * *", even where, as here, the taxpayer is faced with a naked petition, alleging necessity and nothing else (Gov't. Br., p. 20).

The Government's argument completely ignores the integrated nature of those sections of the Internal Revenue Code which are here of critical concern, particularly of those sections which define the interplay between the power of the Internal Revenue Service and the responsibility of federal district courts in enforcement cases. This Court recently recognized, in **Reisman v. Caplin**, 375 U. S. 440, 450 (1963), "* * * the comprehensive procedure of the Code, which provides full opportunity for judicial review before any coercive sanctions may be imposed. * * *" The entire thrust of the **Reisman** case is that, in an enforcement proceeding by the Internal Revenue Service, the taxpayer is entitled to an adversary hearing in which he may obtain a judicial determination of his challenges, on any appropriate ground, to the summons, 375 U. S. at pp. 446, 449.

Those sections of the Internal Revenue Code which deal with the jurisdiction of district courts and the pro-

6. The Government suggests that the main purpose of Section 7605(b) was to avoid repetitious re-examinations of taxpayers by overzealous agents, and that this danger is completely overcome where the determination to make the examination is reviewed by the agent's superior, the Regional Commissioner (Gov't. Br., pp. 17-20). As to this argument, see *infra*, pp. 36-39.

cedures for enforcement of an Internal Revenue summons have existed for many years, dating back to 1913 and earlier. They have been before Congress and, with minor changes, have been re-enacted in major revisions and codifications of the Internal Revenue laws. The position which is here being urged by the Government—that, in order to obtain judicial enforcement of an Internal Revenue summons, no showing of probable cause or reason to suspect fraud need be made—is essentially the same as that which was urged and rejected as early as 1937. **In re Andrews' Tax Liability**, 18 F. Supp. 804 (D. Md., 1937); **In re Brooklyn Pawnbrokers, Inc.**, 39 F. Supp. 304 (E. D. N. Y., 1941). Following these decisions, the Internal Revenue Service apparently accepted the rule that, in order to obtain enforcement, a showing of probable cause or reasonable ground for suspicion of fraud had to be made in order to gain access to books and records for closed years. **Martin v. Chandis Securities Co.**, 128 F. 2d 731, 735 (C. A. 9, 1942). No change in the language of the jurisdiction and enforcement sections of the Code was sought. Rather, the Internal Revenue Service has renewed its contentions in the courts, seeking favorable language while, at the same time, presenting a factual showing. Only in this case has the Service put its position squarely at risk by filing a petition devoid of information as to the basis upon which access to the taxpayer's books and records was being sought, refusing even to produce a witness.

It is our position that the provisions of the Internal Revenue Code must be read together, just as Judge Hastie did. So read, it is plain, and this Court's recent decision in **Reisman** underscores the conclusion, that the Internal Revenue Service, in order to obtain judicial enforcement of a summons which seeks access to books and records for closed years, must do more than merely assure the district court that it has been administratively determined that such examination is necessary. Rather, the Service carries the burden of a preliminary showing of reason to suspect the

existence of fraud, or of some other circumstance which would bring the matter within the exceptions to the statute of limitations of Section 6501.

A. The Statutory Scheme: Investigative Power.

Section 7602 charges the Internal Revenue Service with the responsibility of "* * * ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any Internal Revenue tax * * *". In aid of this duty, the Service is empowered to examine books and records, to require testimony, and to compel the production of books and records.

The critical point of departure in the exercise of power under Section 7602 is the date upon which the return is filed. Assessment and collection of federal income tax is largely self-executing. By filing a return, the taxpayer assesses his taxes; by remitting his check, the taxpayer collects his own taxes for the Internal Revenue Service. Section 6501 provides, in chief, that assessment by the Internal Revenue Service of the tax owed by any taxpayer, must take place within three years after the return is filed. After the three year limitations period has expired, "* * * a person is liable for tax * * *" only in the case of "* * * a false or fraudulent return with the intent to evade tax * * *" or "* * * a willful attempt in any manner to defeat or evade tax * * *". Section 6501(c).[7]

In other words, unless one of the exceptions to the three-year statute of limitations is involved, there is no power in the Internal Revenue Service to assess or collect income tax. Absent the power to assess and collect, there is no power to determine liability for tax or ascertain the correctness of any return, and, accordingly, no power to investigate under Section 7602. Section 6501, therefore,

7. Two other exceptions—failure to file a return and extension by agreement—are concededly not involved in this case. Likewise, the six-year statute of limitations, applicable in cases of failure to report more than 25 percent of the amount of gross income reported, is not involved in this case.

imposes a clear limitation on the power to investigate conveyed by Section 7602.

A further limitation on the investigative powers is imposed by Section 7605(b) which provides that no taxpayer "* * * shall be subjected to unnecessary examination or investigations, * * *". The prohibition of Section 7605(b) is, of course, applicable whether or not the proposed investigation under Section 7602 involves taxable years as to which the statute of limitations has expired. If the statute has run, as we have pointed out above, the investigative power under Section 7602 is subject to the further specific limitation which flows from the provisions of Section 6501.

The books and records here in controversy relate to taxable years ending on July 31, 1958 and July 31, 1959 (R. 4a). Federal income tax returns for each of those years were duly filed and had earlier been examined by Internal Revenue Agents, at which time technical adjustments were made and deficiencies were paid (R. 33a). The three-year statute of limitations on further assessment of taxes had run long before February 26, 1963, the date of the form letter of demand sent to the taxpayer by the Regional Commissioner.[8]

Given these facts, it is clear that the power to conduct an investigation under Section 7602 into books and records of closed years cannot, as the Government contends, turn on an unexplained, administrative determination that the proposed examination is necessary. The statute of limitations section, Section 6501, not only imposes a limitation upon the investigative powers but also furnishes, in the circumstances of this case, an objective standard as to what is or is not necessary. Where the limitations period has expired, the demanded examination is presumptively unnecessary. Upon challenge by the taxpayer, the Internal

8. The form letter of February 26, 1963 was sent as a compliance to that portion of Section 7605(b) which requires notice that a second inspection of a taxpayer's books is contemplated.

Revenue Service must overcome this presumption. If there is no basis upon which a reasonable man could suspect a case of fraud or a wilful attempt to evade payment of tax, there is no basis for suspending the three-year bar of Section 6501. If there is such a basis for lifting the time bar, it must be shown when Internal Revenue goes to court for enforcement of its summons. Judge Hastie accurately and succinctly recognized this as the issue presented for decision, based on those sections of the Internal Revenue Code which deal with the investigative power of the Service: "* * * Logically, therefore, a reexamination of his records must be 'unnecessary' within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year * * *" (R. 51).

B. Statutory Scheme: Enforcement.

On the basis of the above analysis of the relationship between those sections which alone govern the Service's power of investigation, it is clear that, when the Service seeks judicial enforcement of a summons which requires the production of books and records for closed years, a showing must be made that the Service is acting within its statutory power. That conclusion is fortified by a consideration of the role of the courts under the enforcement provisions of the Code, particularly in the light of the Government's argument that the court must act on the basis of a bare certification that the proposed investigation has been administratively determined to be necessary.

The petition for enforcement in this case was filed under Section 7604(b) (R. 3a). Commenting on this section, Judge Hastie said (R. 51):

> "* * * we consider it significant that section 7604(b) requires a 'hearing' on the application to enforce the administrative summons at which 'satisfac-

> tory proof' shall be made. We think this provision means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. * * *"

The Government, in this Court, seeks to avoid the force of Judge Hastie's reasoning by a so-called confession of error. Its brief describes the reference to Section 7604(b) in its enforcement petition as "* * * mislabelling * * *" and attributes this "* * * mislabelling * * *" to the portion of this Court's decision in the **Reisman** case (375 U. S. at pp. 448-449) which condemned the use of body attachment except in cases of contumacious refusal (Br., p. 11, ftn. 2).[9] The Government says nothing as to alternative enforcement sections—Sections 7604(a) or 7402(b)—or the scope of the hearing which would be required if such alternative had been selected. The suggestion seems to be that a satisfactory showing of probable cause justifying enforcement of a summons need be made only under Section 7604(b).

There are a number of dispositive answers to this suggestion by the Government that Judge Hastie's reasoning, which led him to conclude that a hearing was required, should be discounted because he "erroneously" referred to Section 7604(b).

First, we question whether the Government can be permitted, on the basis of its allegedly mistaken use of Section 7604(b), to seek to better its position here by attempting to delete from the case any consideration of the enforcement sections of the Code. A true confession of error, based on original mistake or an intervening ruling which affects the case, should lead to a withdrawal by the party making confession. Here, in contrast, the Govern-

9. The Government also makes a technical argument based on the language of Section 7604(b) to the effect that the "* * * hearing * * *" on the validity of the summons, referred to in that section, takes place after the attachment which the section permits (Br., p. 11). This recognizes that an adversary proceeding on the merits is required.

ment employs its alleged mistake as a device for arguing a new position, namely, that the enforcement sections of the Code need not be examined or construed in resolving the issue presented.

That this "mislabelling" argument of the Government is a mere stratagem, designed to further its argument in this Court, can easily be demonstrated. The choice of enforcement section does not determine whether or not a hearing is necessary, a fact which the Government itself has plainly recognized. In its brief to this Court in **Reisman v. Caplin**, Oct. T., 1963, No. 119, the Government emphasized that a hearing would be required "• • • whether the Commissioner proceeds by way of section 7402(b), 7604(a) or 7604(b) • • •" (Gov't. Br. in No. 119, p. 18). The position taken by the Government in **Reisman** is correct and completely refutes the suggestion here being made that Judge Hastie's conclusion as to the need for a hearing disappears because he referred to Section 7604(b) rather than to another enforcement provision.

Second, the Government's suggestion places it on the horns of a dilemma. Essentially, the Government is arguing that this entire proceeding, from the outset, was incorrect. If that be so, the Government is out of court. *Cf.* **Application of Howard**, 325 F. 2d 917, 919-920 (C. A. 3, 1963). If the Government is not willing to accept this result, it must then accept the record as made and argued to both courts below by its experienced tax attorneys. In other words, under the latter alternative, the case must be considered as involving Section 7604(b).

Third, the Government's attempt to delete from the case any consideration of the enforcement sections of the Internal Revenue Code amounts to raising an argument not made in either court below and one which materially affects the consideration of the issue presented. We respectfully suggest that, as petitioner, the Government may not be per-

mitted thus to alter the nature of the case, to its advantage, by a so-called confession of error.

In any event, there is no substance to the Government's suggestion that some difference would have resulted, as to the requirement of a hearing, if this case had been instituted under Section 7604(a) or 7402(b). As the Government itself stated in its brief in the **Reisman** case, a hearing would have been required in any event and precisely the same issue as to the need for a showing by the Service of probable cause as a condition precedent to judicial enforcement would have been presented.

Section 7604(b) plainly prescribes an adversary proceeding. It is equally plain that Section 7604(a) requires an adversary proceeding.

Section 7604(a) provides:

> "(a) *Jurisdiction of district court.*—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data." [10]

It was early noted that—unlike Section 7604(b) and its predecessor section—Section 7604(a) created jurisdiction but contained no provision specifying the procedure to be followed in invoking that jurisdiction; that accordingly the Federal Rules of Civil Procedure would apply, with the

10. Section 7402(b) is substantially identical with Section 7604(a) in that it vests jurisdiction in the district courts to enforce summons. Section 7604(a) differs from 7402(b) only in that it includes "records" among the taxpayer's papers which may be compelled, and in that it defines venue as the district where the taxpayer "resides or is found" rather than the district where the taxpayer "resides or may be found". Both Section 7604(a) and Section 7402(b) derive from Section 3633 of the Internal Revenue Code of 1939. The reason for the appearance of the section at two places in the 1954 Code is obscure.

proceedings instituted by the filing and service of a complaint. **Martin v. Chandis Securities Co.**, 128 F. 2d 731, 734 (C. A. 9, 1942); see, also, **United States v. Ryan**, 320 F. 2d 500, 501 (C. A. 6, 1963), No. 12, this Term; **Application of Howard**, 325 F. 2d 917, 919-920 (C. A. 3, 1963).

In other words, if this proceeding had been instituted under Section 7604(a), the initial pleading would have been a complaint, followed by answer and hearing. There may be some difference in the immediacy of coercive sanctions as between the two sections, but there is no possible difference in the nature of the hearing to be held on the validity of the summons. Under either section, 7604(a) or 7604(b), an adversary hearing takes place in which the Internal Revenue Service is called upon to satisfy the court, by a showing of probable cause, that it is acting within its jurisdiction.

An examination of the reported cases completely bears out the fact that the issue presented, the nature of the showing which the Service must make in order to obtain enforcement, is the same whether the proceeding be instituted under Section 7604(a) or Section 7604(b). Three reported cases involved body attachment proceedings under Section 7604(b). **Brownson v. United States**, 32 F. 2d 844 (C. A. 8, 1929); **Jarecki v. Whetstone**, 192 F. 2d 121 (C. A. 7, 1951); **Boren v. Tucker**, 239 F. 2d 767 (C. A. 9, 1956). Three of the reported cases state that the enforcement proceeding was brought under Section 7604(a) or its predecessor. **McDermott v. John Baumgarth Co.**, 286 F. 2d 864 (C. A. 7, 1961); **People's Deposit & Trust Co. v. United States**, 212 F. 2d 86 (C. A. 6, 1954); **Falsone v. United States**, 205 F. 2d 734 (C. A. 5, 1953). And four of the cases were said to have been brought under Section 7604 but no reference is made to the particular sub-section involved. **Foster v. United States**, 265 F. 2d 183 (C. A. 2, 1959); **United States v. Ryan**, 320 F. 2d 500 (C. A. 6, 1963); **O'Connor v. O'Connell**, 253 F. 2d 365 (C. A. 1, 1958); **Wall v. Mitchell**, 287 F. 2d 31 (C. A. 4, 1961). In

all of these cases, irrespective of the specific part of Section 7604 which was invoked by the Internal Revenue Service, the courts considered the same issues to be involved and the Government accepted that reading of the statute.

In short, the Government cannot eliminate from consideration the critical enforcement sections and the responsibility imposed on the courts by those sections by a confession that this case should have been brought under Section 7604(a) instead of 7604(b). Here, again, the dispositive principle has been expressed by this Court in **Reisman**. The Court held that, whatever form enforcement took, the taxpayer was entitled to a judicial determination of his challenge to an Internal Revenue summons in a full adversary proceeding. 375 U. S. at pp. 446, 449, 450. In the instant case, the taxpayer pointed out from the outset that the statute of limitations had run on the years in question and called upon the Service to justify the proposed investigation. The Service could, as it did, refuse flatly the taxpayer's request at the administrative hearing. But when the Service sought judicial enforcement, it was under a duty to establish, to the district court's satisfaction, that it was acting within its statutory power. This duty was in no way discharged by a flat refusal to show any facts upon which a reasonable man could have suspected the existence of fraud.

C. The Cases: Constitutional Decisions.

As we have shown, the Internal Revenue Service refuses to recognize the inter-relationship between Section 6501, the statute of limitations section, Section 7605(b), prohibiting "* * * unnecessary examination or investigations * * *", and Section 7602, the power to investigate section.

The Government also makes an argument based on Section 7602, standing alone, an argument which, again,

avoids the difficult issue of statutory authority and is designed to lead to the conclusion that the Service itself can administratively determine the scope of its statutory authority (Br., pp. 12-13).[11]

Assuming the statutory validity of the purpose for which the investigation is undertaken, the Internal Revenue Service urges that the only question is the relevancy and materiality to the investigation of the information sought. On these assumptions, the Government cites **Oklahoma Press Pub. Co. v. Walling**, 327 U. S. 186 (1946), and **United States v. Morton Salt Co.**, 338 U. S. 632 (1950), both for the proposition that the requirement of relevancy and materiality contained in Section 7602 is precisely the same as that announced by this Court in those cases. The Government, of necessity, argues from these cases that not only has the Internal Revenue Service the power to determine the relevancy and materiality of the information sought, but also has the power to determine its own authority to conduct the investigation. In those cases, involving Fourth and Fifth Amendment challenges to the exercise of administrative investigatory power, this Court has always adjudged the constitutional issue on the premise that the administrative investigation was within the statutory authority of the agency. In this case, of course, the scope of the Internal Revenue Service's statutory authority is the very question at issue.

Thus, in **Oklahoma Press Pub. Co. v. Walling**, *supra*, this Court pointed out that "* * * the Administrator's action was in exact compliance * * *" with the broad grant of statutory power conveyed to him by Congress (327 U. S., at p. 201). On this premise, the Court proceeded to consider the constitutional objection to the particular exercise of statutory power, and it was in connection with

11. In connection with this argument, the Government also recites other sections of the Code, such as Sections 6201, 7601, 6001, which, while they spell out various aspects of the investigative power of the Service, are of no relevance here.

the constitutional issues that the Court used the "reasonableness" test relied on by Internal Revenue Service here.

The teaching of **Oklahoma Press** is that, to sustain the constitutionality of a particular administrative investigation, it is enough that the investigation is reasonably related to duties imposed on the agency by Congress in the proper exercise of its legislative powers. But, throughout its opinion, this Court repeatedly insisted that, without regard to constitutional issues, the administrative inquiry must be within the scope of the investigatory power granted by Congress. Thus, the Court states, "It is enough that the investigation be for a lawfully authorized purpose * * *" (327 U. S., at p. 209) and that the administrative official involved "* * * shall not act arbitrarily or in excess of his statutory authority * * *" (327 U. S., at p. 216). In **Oklahoma Press**, this Court plainly held that "* * * The Administrator is authorized to enter and inspect, but the Act makes his right to do so subject in all cases to judicial supervision. Persons from whom he seeks relevant information are not required to submit to his demand, if in any respect it is unreasonable or overreaches the authority Congress has given. To it they may make 'appropriate defence' surrounded by every safeguard of judicial restraint. * * *" 327 U. S., at p. 217.

United States v. Morton Salt Co., 338 U. S. 632 (1950) adds little to the Government's argument. There, this Court held that the Federal Trade Commission, in the exercise of its broad statutory powers to investigate, could demand continuing reports of compliance with a cease-and-desist order. In the instant case, the Government quotes language from **Morton Salt** in which this Court rejected the notion that judicial limitations could be engrafted upon the extremely broad investigative powers which had been conveyed by Congress to the Federal Trade Commission (Br. p. 13). But the question whether the Federal Trade Commission is subject to judicially imposed limitations in the exercise of investigatory powers under its organic act is

not, we suggest, relevant to the question whether the Service can, in the circumstances of this case, flatly decline to disclose any basis for its proposed investigation.

Here, the taxpayer has challenged the statutory authority of the Service to make the proposed investigation, on the ground that there was no reason to believe that the investigation was directed at a proper purpose in view of the time bar. This Court's recent decision in **Reisman v. Caplin**, *supra*, is replete with references to the taxpayer's right to question the propriety of an Internal Revenue Service summons in an adversary proceeding. "Any enforcement action under this section [Section 7402(b), the general jurisdictional section identical with Section 7604 (a)] would be an adversary proceeding affording a judicial determination of the challenges to the summons and giving complete protection to the witness. * * *" Id., 375 U. S. at p. 446. "* * * **the Government concedes** that a witness or any interested party may attack the summons before the hearing officer. * * *" Id., 375 U. S. at p. 445. (Emphasis added.) "Furthermore, we hold that in any of these procedures [under Section 7210, Section 7402(b) or Section 7604(b)] before either the district judge or United States Commissioner, the witness may challenge the summons on any appropriate ground. * * *" Id., at p. 449.

D. The Cases: The Basis for Enforcement of an IRS Summons.

In the two cases before this Court today—this case and **United States v. Ryan**—the Internal Revenue Service asserts that it possesses a statutory right to unlimited access to any taxpayer's books and records, so long as a local Regional Commissioner subjectively believes that examination of the records is necessary. The Government takes the determination of the Regional Commissioner "* * * that an additional examination was necessary * * *" (Br., p. 20), adds the presumption of regularity in acts done by public officers and concludes that "* * * the district court

should have enforced the summons on this basis alone." (Br., p. 20).

Contrary to the Government's statement (Br., p. 8), there is no square decisional support for this conclusion. There is no case anywhere, in which a district court has ordered enforcement of a summons requiring a taxpayer to produce records for closed years where, as here, the Government has declined to show the basis for its investigation. There have been cases in which the Government has argued that it need do nothing more than state a subjective suspicion of fraud, but when the lines were drawn, the Government disclosed facts which recognized the burden of establishing probable cause or reasonable ground for suspicion of fraud. When the burden was not met, enforcement was denied by the courts.

The cases may be divided into three categories.

In one category of cases, the Fourth and Seventh Circuits, while declining to formulate a fixed standard, were careful, in affirming district court orders enforcing a summons, to note that the Government evidence met the test of probable cause. **Wall v. Mitchell**, 287 F. 2d 31 (C. A. 4, 1961); **McDermott v. John Baumgarth Co.**, 286 F. 2d 864 (C. A. 7, 1961). The Government agrees with this reading of these cases (Br., pp. 8-9).

The principle developed in a second category of cases, cases arising out of the First and Ninth Circuits, as well as the court below, results in a judgment adverse to the Government on the facts of this case since they state a "probable cause" or "reasonable ground to suspect fraud" test.

One of the leading cases in this category is **O'Connor v. O'Connell**, 253 F. 2d 365 (C. A. 1, 1958). There, the Court reversed an order directing the taxpayer to appear and testify as to tax liabilities for closed years. The Special Agent testified that "substantial increases in the net worth of the respondent during the years in question led him [the Agent] to strongly suspect that the respondent taxpayer

has grossly understated his income . . . and that his return may have been false and fraudulent."

The Court stated the question as follows (253 F. 2d at p. 369):

> "* * * Our concern is with what the tax authorities must show to warrant enforcement of a summons directing a taxpayer himself to testify with respect to possible deficiencies in his taxes for years 'closed' by the statute of limitations except for fraud. The question is: Do the tax authorities only need to show the enforcing court that they entertain a *bona fide* suspicion of fraud on the part of the taxpayer for those years, or must they establish to the satisfaction of the court that there is probable cause or a reasonable basis for it to believe that in those years the taxpayer perpetrated a fraud upon the revenue?"

The Court recognized the importance to the enforcement of the tax laws of the rule that the Service is entitled, as a matter of right, to compliance with any reasonable summons respecting years not barred, without regard to the burden on the taxpayer. But the Court pointed out that, as time passes, the burden of such examinations on the taxpayer increases. Memories fade; records may be lost or mislaid; to conserve space, honest taxpayers may well destroy records relating to years as to which the statute of limitations has run, especially where an audit has been held; and finally, those who have prepared the returns or assisted in their preparation may have died, moved away, or for one reason or another, be no longer available.

The opinion in **O'Connor** states the rationale of this line of cases (253 F. 2d at pp. 369-370).

> "We may well assume that considerations such as these had weight with Congress when it legislated in § 7605(b) to curb excessive administration zeal by protecting taxpayers from unnecessary examination and investigation. But if these considerations are to be

adequately served we cannot adopt the Government's contention that to obtain an order for enforcement as to a 'closed' year all that the Secretary or his delegate needs to show is the honesty of his subjective belief that fraud existed in such a year. The reason for this is that in the Government's view the necessity for an examination into a closed year would for all practical purposes be left to administrative determination and § 7605(b) would be relegated to hardly more than a pious exhortation directed to the tax authorities. As a practical matter, according to the Government's contention, the court's function under § 7604 would be reduced to little more than that of summarily affixing its stamp of approval to administrative action * * *

"To make the Congressional purpose expressed in § 7605(b) to protect taxpayers from unnecessary examinations truly effective we think the Secretary or his delegate, when a court order is needed to enforce compliance with a summons to testify as to a 'closed' year, should be required to establish to the court's satisfaction that there is probable cause for an investigation into such a year. We think Congress intended to give taxpayers this much protection when the investigation of their returns may reach far back into the past, * * * and that to require such a showing does not impose too heavy a burden upon the tax authorities or unduly restrict or hamper them in tax enforcement."

A year and a half later, in **Lash v. Nighosian**, 273 F. 2d 185 (C. A. 1, 1959), *certiorari denied*, 362 U. S. 904, another Internal Revenue Service summons directed to a taxpayer was challenged before the First Circuit Court of Appeals. The court reaffirmed its earlier holding in **O'Connor v. O'Connell**, and faced the narrower issue which had been raised in the district court as to "* * * the nature and

extent of the burden resting on the petitioner [IRS] to show probable cause or reasonable ground for suspicion of the existence of fraud.'' 273 F. 2d at p. 189. The court held (273 F. 2d at p. 189):

> ''* * * The function of the district courts in these cases as we see it is comparable to the function of a grand jury. It is to prevent the Secretary or his delegate from going on a 'fishing expedition' into a taxpayer's books or records for closed years, or from acting upon a mere hunch or a vague surmise, but to permit inspection as to closed years when the court is satisfied, meaning persuaded or content, that the official who issued the summons had a reasonable basis for his belief that the taxpayer had been guilty of fraud in a closed year. * * *''

The decision by the Court of Appeals for the Ninth Circuit in **DeMasters v. Arend**, 313 F. 2d 79 (1963) falls into this same category. The court there formulated new terminology in lieu of the phrases ''probable cause'' and ''reasonable ground for suspicion of fraud''; i.e., ''if it appeared that the decision [of the Commissioner] to investigate in aid of that purpose [to ascertain whether fraud is present] was in fact reached as a matter of rational judgment based on the circumstances of the particular case, then the investigation would not be an 'unnecessary' one prohibited by Section 7605(b) * * *''.

In the **DeMasters** case, the Internal Revenue agent had begun his investigations in 1957, several years prior to issuance of the summons; had prepared net worth computations from various extrinsic sources, and had examined the records of a branch of the First National Bank of Portland. 313 F. 2d at p. 83. All this took place before the agent had a summons issued against the main office of the First National Bank of Portland. 313 F. 2d at p. 84. When this summons was challenged in a suit to enjoin enforcement, the agent testified at length as to his

net worth computations and his analysis of the taxpayers' bank deposits at the First National branch during one of the closed years. 313 F. 2d at p. 84.

It was in the context of this type and quantity of proof that the Ninth Circuit Court of Appeals articulated its "rational judgment" yardstick. The contrast with the proof, or rather with the total lack of proof, in the instant case, is obvious. The decision of the court below here expressly adopts the reasoning of the First and Ninth Circuits in the cases cited above (R. 52-53) and recognizes the test as being that "* * * which might cause a reasonable man to suspect that there has been fraud * * *" (R. 51).[12]

Thus, the Courts of Appeals for three Circuits—the First, Third and Ninth—expressly require a showing of probable cause, or an equivalent level of proof, as a necessary condition to enforcement of an Internal Revenue Service summons which seeks access to books and records for closed years; and the Courts of Appeals for two other Circuits—the Fourth and Seventh—having expressly found such proof to have been adduced in such cases did not find it necessary to pass upon the validity of the extreme proposition of law presented by the Government.

Cases from three other Circuits—the Second, Fifth and Sixth—give rise to the third category of cases; the category of cases on which the Government principally relies here (Br., pp. 8-9). Upon careful analysis, however, these are all cases in which, while their language indicates a broad view of the Internal Revenue Service's power, enforcement of the Service's summons was actually granted on the basis of records containing a factual showing, not on the basis of a bare allegation such as that here offered

12. An earlier case in the Third Circuit applied the "probable cause" test. **Zimmerman v. Wilson**, 105 F. 2d 583 (C. A. 3, 1939). In that case, the district judge had conducted a hearing at which extensive evidence pertaining to certain stock transactions between the taxpayer and his wife in which large losses had been taken. The district judge concluded that the Government's evidence established probable cause and his appraisal was accepted by the Court of Appeals.

by the Government. **United States v. Ryan**, *supra*, is such a case. While the court's opinion there contains broad language as to the nature of Internal Revenue Service's power to investigate, the opinion was rendered on the basis of a record which plainly showed that, in the district court, factual support had been adduced to support the application for enforcement of the summons.

In the **Ryan** case, the Revenue Agent testified at length in the trial court as to his investigation of the taxpayer's records for later tax years, his net worth computations as to those years, and the deficiencies he had determined. The books and records for closed years were demanded for the purpose of determining not only the correctness of returns for those years but also returns for later years as to which assessment and collection was apparently not time-barred. The Court of Appeals for the Sixth Circuit specifically stated in **Ryan**: "We think the District Court was justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary." 320 F. 2d at p. 502.

Obviously, the **Ryan** case does not stand for the proposition asserted by the Government in its brief (Br., p. 8), namely, that the Sixth Circuit is "* * * satisfied when it is shown that the examination sought may be relevant and material to any of the purposes for which the Commissioner is authorized to make inquiry".

A second case in this line is **Foster v. United States**, 265 F. 2d 183 (C. A. 2, 1959). There, the taxpayer under investigation was a non-resident citizen of the United States whose income had been derived from his own individually owned businesses abroad. Two affidavits were filed by the Special Agent in support of an administrative summons addressed to a bank, one of which was said in the opinion not to be essential to the court's decision (265 F. 2d at p. 186). The other affidavit described the taxpayer and his non-resident citizen status, the companies

from which he derived the money in question, his individual ownership of the companies, and so forth. The affidavit concluded that the books and records were needed "• • • to authenticate the exclusion of income claimed • • • to have been received as salary • • •" and to determine "• • • whether the income received • • • actually represents salary or the distribution of profits • • •", 265 F. 2d at p. 186.

On the basis of that affidavit, the Second Circuit Court of Appeals said (265 F. 2d, p. 186):

> "The simple uncontroverted allegations of fact in the agent's affidavit, as summarized in the foregoing text of this opinion, were enough, we hold, to support the [enforcement] order below." [13]

In other words, the question squarely considered was one of quantum of proof and burden of going forward.[14] The showing in **Foster** might well rise to the level of probable cause or reasonable ground to suspect fraud as required by the five Circuits already discussed, including the court below, but certainly this case does not support the Government's position in its brief (Br., p. 8) that the Second Circuit is "• • • satisfied when it is shown that the examination sought may be relevant and material

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13. In his opinion in the instant case, Judge Hastie remarked (R. 51):

> "If facts are alleged in the petition or in a supporting affidavit as the basis of the agent's suspicion and are not denied in a responsive pleading there may be no need to take testimony. Otherwise, the agent must present evidence showing some rational basis for his suspicion."

14. Judge Hastie also noted (R. 53):

> "Probably the Sixth and Ninth Circuits would sustain administrative judgment as to the need for reexamination of records of closed years upon a less impressive showing of suspicious circumstances than the First Circuit would require. However, this is a matter of quantum of proof which does not concern us here because no showing whatever has been made as to the basis of the special agent's suspicion."

to any of the purposes for which the Commissioner is authorized to make inquiry * * *".

Furthermore, to the extent that **Foster** might be said to have loosened the restraints on enforcement of an Internal Revenue Service summons in the Second Circuit, the loosening has since been limited to inquiries directed against third parties, that is, individuals such as banks or accountants who are in possession of a taxpayer's books and records, but are not themselves the taxpayer. **Application of Magnus**, 299 F. 2d 335 (C. A. 2, 1962), *certiorari den.*, 370 U. S. 918. In **Magnus**, one Internal Revenue Service summons had been served on a corporation in which one of the taxpayers under investigation was President, director and shareholder, and another summons had been directed to the accountants who prepared the tax returns for the taxpayers and their corporation. The court of appeals sustained the denial of the taxpayers' motion to quash the summons on several grounds, including the ground that the protection of Section 7605(b) against "unnecessary" examination extended only to the taxpayer, and that the taxpayers lacked standing to assert the claim where the books and records of a third party were involved.[15] The court of appeals expressly based its holding on the fact that a taxpayer was not involved, saying that third parties have only the protection accorded by the courts against burdensome or irrelevant subpoenas, but that "* * * as to taxpayers, nothing said so far prevents them from enjoying the benefits of this Section [Section 7605]." 299 F. 2d at p. 337. Thus, it can be said that, while the view of the Second Circuit Court of Appeals is not entirely clear, the Circuit clearly does not follow the principle attributed to it by the Government in its brief.

Finally, the decision of the Court of Appeals for the Fifth Circuit in **Globe Construction Co. v. Humphrey**, 229

15. This aspect of the holding of the Second Circuit Court of Appeals in **Magnus** appears to be in conflict with the decision of this Court in **Reisman v. Caplin**, *supra*.

F. 2d 148 (C. A. 5, 1956) falls into this category; yet it is one of the cases on which the Government here relies. The opinion in **Globe Construction Company** consists of three short paragraphs, the court's view being stated in a single one of them. The Government contended that the "• • • allegations in the affidavit of the officer who issued the subpoena were sufficient to support its issuance • • •". 229 F. 2d at p. 148. The court said: "We agree. Indeed we think: that the insistence of the appellant to the contrary proceeds from a misconception of the nature of the subpoena power at issue here and of the conditions requisite to its exercise." *Ibid.*

This cryptic opinion does no more than hint at the nature of the showing in the case. However, reference to the official court files in the case reveals that the Government agents filed two affidavits in the case, clearly revealing to the court and the taxpayer the basis for the Internal Revenue Service's belief that fraudulent returns might have been filed.

The first affidavit stated that the Special Agent's investigation of the company for the fiscal years 1951, 1952 and 1953 (apparently years as to which the time bar of the statute of limitations had not yet run) revealed certain practices by the company which warranted the imposition of substantial additional tax liabilities for these years, and that there was reasonable ground for believing that the same practices had been followed in the fiscal year 1950, the year as to which records were being sought, and which was a closed year. The second affidavit was filed a month later and made specific the allegations of the first affidavit. It was to the effect that the particular practices involved in all four returns (1951, 1952, 1953 and the year in question—1950) consisted of showing false and fraudulent allocations of construction costs in contracts between the Globe Construction Company, Inc., and the partnership of Christopher and Schlesinger; that the partnership was composed of Christopher, the President of Globe Construction

Company, and Schlesinger, the Secretary of that company; and that these false allocations between the construction company and the partnership resulted in false and fraudulent income tax returns being filed by Globe Construction Company and false and fraudulent partnership income tax returns being filed by Christopher and Schlesinger.

Obviously, this case does not stand for the proposition that the Fifth Circuit Court of Appeals is "* * * satisfied when it is shown that the examination sought may be relevant and material to any of the purposes for which the Commissioner is authorized to make inquiry * * *" (Gov't Br., p. 8). The allegations of the affidavits gave the exact items in specific income tax returns which were involved, and stated the precise basis for the Internal Revenue Service belief that the returns contained fraudulent entries. In other words, in the **Globe Construction Company** case, the cryptic language of the opinion, read in the light of the content of the affidavits, gives no support whatever to the Government in this case. The court there, as in every case where enforcement has been granted, had the benefit of a factual demonstration of the propriety of the investigation and examination.

The plain fact of the matter is that none of the eight Courts of Appeals which has addressed itself to this matter has rendered a decision which, upon careful analysis, even remotely supports the proposition that enforcement of an Internal Revenue Service summons would be granted on the basis urged in this case.

E. Legislative History.

Continuing on the assumption that Section 7605(b), taken alone, is here critical, the Government sets forth excerpts from the legislative history of that section intended to show that its major purpose was to prohibit harassing reexamination of taxpayers' books and records by overzealous agents.

We do not perceive that this contention, or the legislative history excerpts from which it derives, further the Government's case here. The avoidance of harassment was a purpose of the section, but the excerpts quoted by the Government also indicate full awareness on the part of Congress that there were other relevant sections of the Code and other obligations imposed on the Service. Thus, Congressman Hawley said (Gov't. Br., p. 17):

> "• • • It ought to be settled once for all when a man pays his tax, unless there should be good cause for a reexamination • • •."

Congressman Hawley's remark is entirely apposite to the circumstances of this case. Here, the return has been filed, the tax paid, a reexamination made and additional deficiency assessments paid. As the Congressman noted, the matter "• • • ought to be settled once for all • • •" unless the Service has "• • • good cause • • •" for further investigation. The Government is undoubtedly of the view that "• • • good cause • • •" need exist only in the mind of the Commissioner. However, it is clear that, in light of all of the relevant sections of the Code, the existence of good cause here, reason to suspect the existence of fraud, must be demonstrated to the court whose enforcement powers are invoked.

In fact, the most forceful indication of the meaning of these sections of the Code, as a matter of legislative history, is furnished by applying the principle that Congress, reenacting the precise language of a statute after the courts have construed it, will be presumed to have accepted the meaning thus attributed to the statute. **Shapiro v. United States**, 335 U. S. 1, 16 (1948); **Missouri v. Ross**, 299 U. S. 72, 75 (1936).

In the earliest case which addressed itself to the statutory question here involved, **In re Andrews' Tax Liability**, 18 F. Supp. 804 (D. Md., 1937), the District Court for the District of Maryland enforced an Internal Revenue Service

summons as to certain tax years, because, in the district judge's words, "* * * the Government has shown what may be fairly stated to be reasonable grounds of suspicion or probable cause for the examination to ascertain if there has been fraud". 18 F. Supp. at p. 807. By the same token, the district judge there denied enforcement of the summons as to another tax year, saying, "But no reasonable ground of suspicion of fraud or probable cause with regard thereto has been shown by the Commissioner which would justify enforcement of examination of the taxpayer's books for 1931, as to which one examination has already been made without disclosing the existence of any fraud; and another further examination at this time of the taxpayer's books and records for that year would seem to be unreasonable. * * *" 18 F. Supp. at p. 807.

There was an entire re-enactment, including the statutory language here involved, of the Internal Revenue Code in 1939. In that same year, the Court of Appeals for the Third Circuit, in **Zimmerman v. Wilson,** 105 F. 2d 583 (C. A. 3, 1939), adopted the reasoning of the **Andrews'** opinion quoted above and sustained enforcement of a summons because probable cause had been shown.

In 1941, the District Court for the Southern District of New York denied enforcement of an Internal Revenue Service summons in **In re Brooklyn Pawnbrokers** (1941) on the ground that the mere conclusory allegation in the affidavit of the agent that "* * * the taxpayer willfully and fraudulently understated his gross income for the years involved * * *" was not a sufficient showing. See, also, the opinion in **Martin v. Chandis Securities Co.,** 128 F. 2d 731, 735 (C. A. 9, 1942) where the court noted that the Service accepted the statutory obligation of showing probable cause.

The Internal Revenue laws were again codified and re-enacted in 1954. And, as we have shown, Sections 7402(b) and 7604(a) of the 1954 Code are re-enactments, with very slight modification, of Section 3633 of the 1939 Code.

In other words, as this Court stated in **Missouri v. Ross**, 299 U. S. at p. 75,

> "* * * Congress in the face of these decisions has permitted the [language] as it now appears * * * to stand for many years without change in its phraseology, although amending that portion of the [Internal Revenue] Act in other particulars. This is persuasive evidence of the adoption by that body of the judicial construction. [Cit.]"

Again, in **Shapiro v. United States**, 335 U. S. at p. 16, the Court said,

> "* * * there is a presumption that Congress, in re-enacting the * * * provision of the * * * Act, was aware of the settled judicial construction of the statutory [language]. In adopting the language used in the earlier act, Congress 'must be considered to have adopted also the construction given by this Court to such language, and made it a part of the enactment.'"

Thus, it is plain, we submit, that both as a matter of original intention in enacting this statutory language, and intention in re-enacting the identical language in the light of existing judicial construction, Congress intended that the Internal Revenue Service be required to show facts "* * * which might cause a reasonable man to suspect that there has been fraud * * *" as a condition precedent to enforcement of a summons such as that here involved. The decision of the court below complies precisely with this intent.

F. The Government's Alternative Argument.

As we noted in the introductory portion of this argument, *supra*, p. 13, the Government—as an alternative to its major contention that it may obtain judicial enforcement of an Internal Revenue summons on the basis of an administrative certification that the inquiry is not unneces-

sary—argues that the general statement of suspicion of fraud contained in the Special Agent's affidavit was a sufficient showing to justify enforcement. The affidavit is described as having "amply demonstrated to the Court that the Regional Commissioner's decision to authorize the reexamination was justified • • •" (Gov't. Br., p. 21).

This question as to the sufficiency of Tiberino's affidavit was not presented by the petition for certiorari and, accordingly, is not available to the Government for presentation. Rule 40(d)(2).

In any event, the argument is without merit. As we have already shown, the order entered by the district judge in this case, directing a one hour examination on condition that the Agent behave courteously, was clearly an attempt to compromise the dispute and avoid any sharp resolution of the question at issue. *Supra*, p. 6. Judge Hastie's opinion, in the court below, considered the Special Agent's general statement of suspicion as no showing at all. He did not consider that the agent had made any disclosure as to those facts which might have created suspicion in his mind (R. 51-52).

The view taken of this Special Agent's affidavit in the court below fully accords with those decisions which have considered the sufficiency of similar general statements of suspicion. See, *e.g.*, **In re Brooklyn Pawnbrokers, Inc.**, 39 F. Supp. 304 (E. D. N. Y., 1941); **United States v. Carey**, 63-1 USTC ¶ 9495 (D. Del., 1963). And, in **McDermott v. John Baumgarth Company**, 286 F. 2d 864 (C. A. 7, 1961), where the Service's petition to enforce had, as an attachment, an affidavit of an Agent containing a general statement almost identical with that here involved—if anything, more specific—the Service produced the Agent as a witness and he, in turn, furnished substantial detailed testimony in support of his general statement. 286 F. 2d at p. 865. Nevertheless, the Government here contends that the Agent's general statement indicated sufficient knowledge on the part of the Service so that the Service "• • • would

have been remiss if it had not pursued its investigation. * * *" (Br., p. 21).

The worth of this contention, and the risk involved if it were to be accepted, is illustrated by reference to a related case, involving a different corporate taxpayer, **United States and Tiberino v. Max Powell,** Misc. No. 2573, E. D. Pa.[16] In origin, this case was, in all respects, identical with the instant case. The same form of petition for enforcement was filed, to which was attached an affidavit by the same Special Agent containing the identical general statement of suspicion of fraud. After the decision of the court below in this case, and certain other proceedings not here material, the Service elected to attempt to substantiate the allegation of fraud in the affidavit by producing, first, additional affidavits, and, second, live testimony by the investigating Agent. After several hearings, submission of briefs and presentation of oral argument, the District Judge, the Honorable Francis L. Van Dusen, concluded that the Service had failed to establish facts and circumstances on which a reasonable man would suspect the existenc eof fraud. Judge Van Dusen's final opinion and order were filed on June 5, 1964. An appeal has been noted by the Government.

As we said above, the proceeding before Judge Van Dusen illustrates the danger, a danger which has always been recognized by the courts, of accepting a general statement of suspicion of fraud as a basis for an order of enforcement. Called upon to substantiate the general charge, the Government has been unable to establish any satisfactory factual basis for its suspicion. Yet, here, the Government argues that the general statement itself should be considered by this Court as a sufficient factual showing.

16. The instant case involves Wm. Penn Laundry, one of a number of corporations formerly owned and controlled by Mr. Lawrence C. Kline. The above cited case, Misc. No. 2573, involves another of Mr. Kline's holdings, Kline's Coat, Apron & Towel Service of Harrisburg.

In essence, the Government's second argument is to the same effect as its principal argument, namely, that no real showing need be made at all. The ultimate thrust of either argument is to reduce the role of the court to that "* * * of summarily affixing its stamp of approval to administrative actions * * *". **O'Connor v. O'Connell**, 253 F. 2d 365, 370 (C. A. 1, 1958); **Lash v. Nighosian**, 273 F. 2d 185, 189 (C. A. 1, 1959), *certiorari den.*, 362 U. S. 904.

We submit that, even if the Internal Revenue Service need not make a preliminary showing when the years at issue are not time-barred (and that issue is not presented in this case), the running of the statute of limitations automatically calls into question the purpose for which the Internal Revenue Service has undertaken an investigation, and thereby calls for some preliminary level of showing that the purpose is proper. None of the Courts of Appeals has permitted itself to become a rubber stamp in the enforcement of Internal Revenue Service summonses; the statutory language does not permit, and certainly does not compel, such a result; and the Internal Revenue Service has advertently, in the light of the many decisions of the federal courts, avoided seeking from Congress the power which, in this Court, it now asserts it already possesses.

CONCLUSION.

For the reasons set forth above, we respectfully submit that the judgment of the court below should be affirmed.

Respectfully submitted,

BERNARD G. SEGAL,
SAMUEL D. SLADE,
THOMAS B. RUTTER,
Attorneys for Appellants.

SCHNADER, HARRISON,
SEGAL & LEWIS,
Of Counsel.

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